

Internal Revenue Service

Number: **200942020**

Release Date: 10/16/2009

Index Number: 1361.00-00, 1361.03-00,
1361.03-01

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-106481-09

Date:

July 07, 2009

LEGEND

Trust =

Grantor =

A =

B =

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to a letter dated February 9, 2009, submitted on behalf of Trust by its authorized representative, requesting a ruling that, pursuant to § 1362(c)(2)(A)(i) of the Internal Revenue Code, the sub-trusts created under Trust qualify as shareholders of X, an S corporation.

FACTS

The information submitted states that Grantor created Trust under State law on Date 1. Trust created four sub-trusts, one for each of Grantor's children. Trust provides that each share constitutes a separate trust but the property of the trusts may be administered as an undivided whole without separation as between the sub-trusts. The beneficiaries of each of these sub-trusts are Grantor's spouse, A, the child for which the sub-trust was created and that child's spouse, and descendants of that child and those descendants' spouses. A and B are the trustees of Trust. Trust represents that B is the only trustee under Trust that has the ability to make discretionary distributions or to amend the Trust agreement and that B is a nonadverse party that is neither related nor subservient to Grantor within the meaning of § 672.

As a result of gifts made by Grantor on Dates 2, 3, and 4, Trust owns shares in X. X filed an election to be an S corporation effective Date 5.

The relevant terms of Trust are:

Article One provides that the trustees (other than Grantor or the Grantor's spouse) may distribute principal and income to the beneficiaries in the trustee's sole discretion.

Article Two provides, in part, that Grantor's spouse shall have the power to withdraw from the principal of the trust property having a value equal to the value of the property added to the trust during such year (including, for the year of the trust's creation, the property creating the trust), provided that the total amount that may be withdrawn shall not exceed the lesser of (i) the maximum amount over which an individual may have a power of withdrawal without its lapse in such year being a release of such power under § 2514(e) of the Internal Revenue Code or (ii) the maximum amount excludible from a donor's taxable gifts for such year in respect of gifts to any donee under § 2503(b) of the Code. Grantor's spouse's power of withdrawal shall lapse 60 days after the addition giving rise to such right of withdrawal.

Article Two also provides that if there is any amount left over after the spouse's withdrawal power, the Grantor's children and their descendants, as provided for in the agreement, would have a power of withdrawal of the amount left over, subject to some limitations. Holders with withdrawal power other than Grantor's spouse have a cumulative power of withdrawal but the total amount which may be withdrawn by each power holder as of December 31 of the preceding year shall be reduced by the greater

of \$5,000 or five percent of the value of the trust principal on January 31 of the current year.

Article Three provides that Trust is an irrevocable trust. The trustees (other than Grantor and Grantor's spouse) shall have the power, by an instrument filed with the trust records, to amend the dispositive or administrative provisions of the indenture (including the provisions relating to the trustees), provided that only descendants of the Grantor (or their estates), the spouses of such descendants, the Grantor's spouse, or charitable organizations shall benefit from any dispositive amendment.

The beneficiaries of the sub-trusts created by Trust received timely notification of their withdrawal rights and no beneficiary has exercised those rights.

LAW AND ANALYSIS

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not A) have more than 100 shareholders, B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, C) have a nonresident alien as a shareholder, and D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter I) as owned by an individual who is a citizen or resident of the United States may be a shareholder in an S corporation. The deemed owner of the trust shall be treated as the shareholder under § 1361(c)(2)(B)(i).

Section 674(a) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Section 674(c) provides, in part, that § 674(a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor (1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or (2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

A power does not fall within the powers described in § 674(c) if any person has a power to add to the beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born, or after-adopted children.

Section 672(a) provides that, for purposes of subpart E, the term “adverse party” means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust. Section 672(b) provides that, for purposes of subpart E, the term “nonadverse party” means any person who is not an adverse party.

Section 677(a) provides, in part, that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor’s spouse; or (2) held or accumulated for future distribution to the grantor or the grantor’s spouse.

Section 678(a) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: (1) the person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or (2) the person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would cause a grantor to be treated as the owner of such portion of the trust within the principles of §§ 671 to 677, inclusive.

Section 678(b) provides that § 678(a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust is otherwise treated as the owner under the provisions of subpart E other than § 678.

Trust provides that B, as trustee, has the power to make discretionary distributions to the beneficiaries and amend the trust to add additional beneficiaries, including charitable organizations. Therefore, Grantor is treated as an owner of the sub-trusts created by Trust under the provisions of § 677 because B may make discretionary distributions from income and principal to Grantor’s spouse. Also, Grantor is treated as the owner of the sub-trusts created by Trust under § 674(a) because B may add additional beneficiaries to the Trust agreement, thus the exception to § 674(a) found in § 674(c) would not apply. Furthermore, because Grantor is treated as the owner of the sub-trusts created by Trust under §§ 677 and 674(a), the provision of § 678(b) would apply so that the powers of appointment possessed by the beneficiaries would not result in those beneficiaries being treated as the owners of their respective sub-trusts under § 678(a).

CONCLUSION

Based solely on the facts and representations submitted, we conclude that Grantor will be treated as the owner of the sub-trusts created under the Trust agreement under §§ 674(a), 677(a), and 678(b). Accordingly, the sub-trusts created by Trust are permitted shareholders in X, an S corporation, under § 1361(c)(2)(A)(i), if otherwise eligible, from Date 5.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for federal tax purposes. Furthermore, we express no opinion on whether the sub-trusts under Trust would continue to be grantor trusts if the trustees use their substitution powers to appoint different trustees.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes